

COOPERATIVE DIRECTOR RESPONSIBILITIES

By

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I am not an attorney and the comments contained herein are not directed to the solution of any specific legal problem. In the event a specific legal question arises in areas discussed in this paper or presentation at this Director's Workshop, advice should be sought from the cooperative's or reader's attorney knowledgeable of cooperative law.

My goal is to call to the attention of participating cooperative directors not only their responsibilities as directors of their cooperative, but also to suggest a few tools and guides that might assist them in discharging their responsibilities individually and as a member of the Board of Directors.

It is not my intent to entertain you or provide any legal advice. I will attempt to point out to you your responsibilities as a director of a cooperative and to suggest tools that you may use to better prepare yourself to discharge your legal and moral responsibilities as a cooperative director. It is also my intent to challenge you to think about your role as a director and to motivate you to establish for yourself a philosophy of cooperatives and cooperative directors that will permit you to discharge your responsibilities in a professional manner.

I hope that I might "aggress" you enough to cause you to "cuss and discuss" this presentation after you return home. But please accept the fact that I am on your side.

A TIME OF CHANGING FACTS

We are living in a time that may prove to be the most difficult and challenging that our agricultural cooperatives have ever known and yet possibly the most rewarding period of time for farmers and their cooperatives. It appears to me that we are living in a time of changing facts. The facts you and I used yesterday to base many of our decisions do not stand up today. For example, what is a sales aid and what is a bribe?

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WHAT IS A CONFLICT OF INTEREST?

In the July 1976 issue of Fortune, Walter Guzzardi wrote, "An emerging American ethic is judging business to be deficient because it does not adhere to new and sweeping principles of conduct. Those ill defined principles somehow go beyond the law, and seek to blend in morality and international standards of behavior as well." Is the bright colored cap you received from your favorite tractor dealer a bribe? A similar emerging ethic is conflict of interest.

From published court cases I think it is a conflict of interest when a director serves on a co-op board that sells seed corn when he sells someone else's seed corn.

New rules are being made every day for cooperatives and their directors as government agencies issue new regulations and judges decide cases before them. Cooperative directors must learn the current rules and search out these new rules for their conduct. This need to search and prepare oneself is indeed a responsibility of cooperative directors.

NEW BALL GAME

Truly today we find ourselves with our cooperatives playing in a "new ball game" and we recognize and hope that you too recognize that you must manage your cooperatives in today's economy with today's rules and keep alerted to new rules that may be imposed on cooperative directors at any time.

President Abraham Lincoln in an inaugural speech answered critics of some of the changes he proposed with an observation that went something like this: "The domas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty and we must rise to the occasion. As the case is new we must think and act anew."

I was recently reminded that President Lincoln also said, "The world will little note nor long remember what we say here."

Dogma means that which is held as opinion.

The case is new. Cooperatives and all corporations are operating in a new "ball game." There is no cooperative director of the past or present that ever managed a cooperative in an economic, social or political climate such as agricultural cooperatives are operating in today.

Today's cooperative director must know what a cooperative is and how it is unique or differs from the other three ways of doing business in our competitive economy. Today's cooperative directors must know the laws, rules and regulations underwhich the cooperative operates and they must not only know their responsibilities as a cooperative director but discharge these responsibilities with dispatch and in a professional manner.

Most of our academic training was based on investor-oriented corporations. There are too many examples of where cooperative directors and staff trained

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in corporate law, corporate finance, corporate planning, etc., have attempted to direct and manage a cooperative the same as an investor-oriented business. Many of these sincere and well meaning but misdirected efforts have resulted in disaster to the individuals and the cooperative because they were not in the right game, thus the unfavorable press and unfavorable attitude toward cooperatives by employees of IRS, SEC, Justice, and etc. Yes, cooperatives must be operated with many of the same management and business principles as other types of business but within the unique characteristics of cooperatives. Once the director understands which game he is playing--in your case managing the cooperative--he must know and understand the rules.

I would not be very successful playing tennis with a golf ball and baseball bat or playing golf with a tennis racket and a volleyball. The same goes for farmers who try to manage their cooperative as if it were not a cooperative.

There are many games played with a round ball; for example, baseball, softball, tennis, golf, basketball, handball, and volleyball. Each game has its own rules and goals and the player must know the rules if he plays the game. The same is true for managing an agricultural cooperative. Directors of cooperatives must not only know what a cooperative is but the rules under which it is to be operated (State Statute, Articles of Incorporation, Bylaws, and marketing or membership agreement).

KNOW YOUR JOB

Next he must as the teamball player, play his position. He must know his specific responsibilities and discharge them as skillfully as possible.

DIRECTOR DEFINED

"A director is one who sits on a Board of Directors of a company or corporation and who has the legal responsibility of exercising control over the officers and affairs of the company or corporation."^{1/}

"A director has a fiduciary duty to the corporation and to its stockholders to manage the affairs of the corporation in a manner which is consistent with their interests. Any breach of this fiduciary duty may subject him to personal liability to both shareholders and the corporation."^{2/}

Fiduciary is defined as "a person having a duty created by his undertaking to act primarily for the benefit of another in matters connected with his undertaking--in the nature of a position of trust or holding confidence."^{3/}

^{1/} Law Directory, Steven Gefets, page 60.

^{2/} Ibid.

^{3/} Ibid., page 83.

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When a member of a cooperative is elected by his fellow members to a position on the Board of Directors he faces a two-fold challenge:

- (1) To represent all stockholders or members of the cooperative not just himself or only the members of his district but the total membership.
- (2) He is vested by law with the responsibility to reasonably conduct the affairs of the business for the welfare of the cooperative.

This two-fold challenge to the farmer director of a cooperative is compounded and made more difficult as cooperative directors are elected democratically by members in their district. As director of the cooperative, they must base their actions on what's best for the cooperative not on what's best for themselves or their neighbors.

The Board of Directors is not only charged with the responsibility for exercising all the authority of the corporation, its management, the safeguarding of the cooperative's assets and the conduct of its business--the Board of Directors is in fact the only group of persons in whom this authority is vested.

The acceptance of an obligation by an individual to serve as a director of his cooperative implies that he recognizes and accepts responsibility of the position, the specific responsibilities set forth in the state statute and in the cooperative's bylaws, and he agrees to discharge these responsibilities to the best of his ability.

The Board of Directors is the governing body of a corporation legally created under state statutes and issued a "charter." The state statutes give the Board authority to exercise all the powers of the corporation limited only by any conditions set forth in the chartering states statute and the corporation's bylaws.

Your state statute that permits the incorporation of cooperatives sets forth your responsibility by stating "The affairs of the Association shall be managed by a Board of not less than five directors, elected by the members or stockholders from their own number."^{4/}

The directors of cooperatives are charged with the management of the total corporation and are responsible for the acts of the principle executive officers of the corporation.

Directors are responsible for the operation of the cooperative within the provisions of the law, the Bylaws, membership and marketing agreement of the cooperative, plus all the regulations of agencies such as OSHA, EPA, SEC, IRS, etc.

^{4/}Chapter 1729.13, Ohio Revised Code.

Section 17-1611 Kansas Corporation Statute.

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The Board of Directors is the governing body of a corporation. The ultimate authority for the management of a corporation rests with the owners. The method of government of a corporation is in the nature representative and is in some respects analogous to the representative democracy with which we are familiar in the government of the United States. Members to the Board of Directors are elected by the shareholders or members and these Boards elect the officers of the corporation.^{5/}

The Board of Directors are the policy-determining bodies of the corporation and is also the body which either generally or specifically authorizes business transactions. Boards of Directors are analogous to Congress.

It is well established in corporate law that the corporation can act only through its Board of Directors except in the unusual situation where stockholders act by unanimous vote at a meeting and the Board of Directors subsequently ratifies the action.

BOARD ACTS AS A GROUP

It must always be remembered that the Board of Directors' decisions are group decisions. The Board is a group; it acts jointly as a Board. It never acts as an individual. Opinions and actions result from the contributions of all the persons making up the Board. The actions of a Board of Directors are conditioned by the background, experience, knowledge, and attitude of its collective membership. In fact, it is the abilities and the application of these abilities of the men who make up the Board of Directors that is the real decisive factor in the growth and accomplishments of any firm.

To discharge their responsibilities, directors must make certain that all their actions are within the powers conferred upon them by laws of the state in which the cooperative is incorporated, the corporation's charter, bylaws, and marketing or membership contracts.

A BOARD MEMBER'S POSITION IS ONE OF TRUSTEESHIP

It is difficult to define all the duties of the Board of Directors. In general, it can be said that members of the Board of Directors are individually and collectively under a continuing obligation to exercise their best judgement and apply such knowledge and experience as they have in the conduct and management of the cooperative's business. Directors must use good faith and exercise the care which is commonly exercised by an ordinarily careful and prudent man under similar conditions. They must have in mind that they are trustees charged with the responsibility of dealing with the rights and properties of others.

Members of the cooperative elect a director to a position of trusteeship. In effect, members legally place their financial interests in the cooperative in the hands of the elected director.

^{5/}Anderson's Ohio Corporate Desk Book, page 4.

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The law says that directors must not take advantage of their position as director to gain profit or benefit for themselves at the expense of the corporation. While some may interpret this to mean that a director should not receive special consideration in his dealings with the management of his cooperative, it now seems this responsibility as a director extends into the competitive economy in which his cooperative operates. To some this means the cooperative director who accepts special price or service consideration not offered to all farmers by competitors of his cooperative is a conflict of interest.

GUIDELINES FOR DIRECTORS

Directors must use care in directing the affairs of the cooperative to keep within the powers conferred upon them by the corporation's charter, bylaws, marketing contracts, if any, and the laws of the State. If the directors exceed their authority, neglect their responsibilities or act in violation of the provisions of the statute, their charter, bylaws, or marketing contracts, legal liability could result.

Bylaws are the rules that the membership has adopted for directors to follow in their operation of the firm. Bylaws perform the same function for a director that a blueprint performs for a builder. The power to adopt bylaws resides in the stockholders or members, and they alone have the power to adopt them. Bylaws are the instructions by the owners to the directors as to how the cooperative is to be operated.

The members of a corporation and its directors and officers usually are conclusively presumed to have notice of bylaws, and of what they contain and hence they are bound to them, although, as a fact they may be ignorant of them. It is advisable that directors make available to each member of the corporation a copy of the bylaws.

Legal liabilities may result from a failure of officers and directors to observe bylaws. The directors as well as the managers are in law simply agents, and agents are bound by the instruction of their principles.

COOPERATIVE DIRECTORS ARE UNIQUE

Directors of some cooperatives are striving so hard to become "just like all other types of business" that they fail to recognize the unique characteristics of a cooperative business organization and basic principles that distinguish the co-op from other types of business associations. It is the responsibility of directors of a cooperative that all the employees of the cooperative and all the membership of the cooperative understand, "what a cooperative is" and that it is a part of our competitive economy.

It is, therefore, the responsibility of each director of a cooperative that all employees of the cooperative and members of the cooperative understand how the cooperative meets the three basic principles that distinguish cooperatives from other businesses that make up our competitive economy: (1) operations at

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cost, (2) democratic control by members and (3) limited returns on capital.^{6/}

CO-OP DIRECTOR SPECIAL

It is important that cooperative directors understand that their position as a director of their cooperative differs from that of a director for other types of business. Directors of non-cooperatives are usually the principle owners of the firm, and they may serve not only as a director of their firm but also serve as one of the executives, such as the general manager. The director of a cooperative is elected democratically without regard to his investment in the cooperative. In fact, the total investment of the president of a cooperative may be one share of membership stock. The cooperative's ownership is not controlled by the Board of Directors as the general corporation.

The director of a cooperative must recognize that, except when the Board is in formal meeting, his authority is equal only to the rights and authority of any individual member of the cooperative. This applies to each director of a cooperative regardless of position he may hold on the Board.

As individuals, the members of the Board of Directors of a cooperative have no authority to act for, or bind the corporation, unless they are duly elected or appointed to do so in legal meeting of the Board of Directors. Cooperatives are unique, they are people; people working together. It is the responsibility of directors to capitalize on the uniqueness of cooperatives.

DELEGATION TO HIRED MANAGEMENT

While the Board of Directors is charged by law with the responsibility of managing the affairs of a business, this responsibility should not be interpreted as meaning the Board should manage the day-to-day operating details of the cooperative. The day-to-day management should be delegated to a competent general manager who is held accountable by the Board for his decisions and performance. The Board is responsible for directing the manager in conducting the cooperative affairs.

The Board of Directors can delegate all operational responsibility and authority to a general manager or in your case to a regional board, but the Board of Directors retains the accountability.

DIRECTORS TELL MEMBERS AND PUBLIC ABOUT THE COOPERATIVE

The cooperative director recognizes that he is responsible for the image of his cooperative.

He must be convinced of the value of the cooperative to himself, his neighbors, and to farming in general, or he should not have accepted the

^{6/}Farmer Cooperatives in the United States, FCS Bulletin No. 1, USDA.

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responsibilities of director. Consequently, he is responsible for developing an accurate understanding in the community of the cooperative's objectives, policies, principles, and benefits. He is responsible for presenting the facts about the cooperative association to the public and for correcting any erroneous ideas people may have about the cooperative.

A cooperative director cannot be satisfied just to wait to be asked about the cooperative; he will seek opportunities to promote it.

By his loyalty to and enthusiasm for his cooperative, he sets and example for the entire membership.

As a rule directors discharge their responsibilities in three ways:

1. They handle their responsibilities directly as a board. They deliberate, make decisions, and give instructions as a unit--not as individuals.
2. They delegate duties to a competent manager.
3. They tell members and the public about the co-op.

POLICIES--A TOOL FOR EFFECTIVE COOPERATIVE DIRECTORS

Current policies are necessary for the employees, manager and board of directors of a cooperative to work together to serve their members.

For a board of directors of a cooperative to effectively discharge its responsibilities, it should be devoting a large portion of each board meeting to policy formulation, policy evaluation and policy implication. Successful cooperative managers formulate policies for the day-to-day operation of the cooperative that will guide all employees in making decisions within the limits of the policies established by the board of directors.

Policies are statements in general terms which give direction to plans and operations. Some boards of directors are kept so busy reacting to situations that they never have time to develop policies to give direction to their cooperatives and thus these directors may never really be in control of their cooperatives.

The law under which cooperatives are incorporated gives the authority to manage the cooperative firm to the board of directors. The board usually delegates some of their authority to a manager. Even if the board of directors passes the authority for policy formulation on to hired management, the elected board of directors is still responsible for the policies under which the cooperative operates.

FINANCIAL STABILITY OF THE COOPERATIVE

Directors have the responsibility to safeguard the financial structure of the cooperative. Directors must request study and use all financial reports necessary to make sound and prudent decisions. Some cooperative

directors prefer to have reports such as monthly statements delivered to them in advance of the meeting in order that they may study them and understand them. Such a practice has merit and directors who receive the important information about their cooperative must protect its confidential value.

Directors have the responsibility of determining the ratio of debt to equity capital. This policy is directly related to the IRS classification the directors choose for their cooperative.

The percentage of patronage returned to patrons in the form of cash is a responsibility of directors and can have an important bearing on the cash flow and stock redemption plans.

Directors must approve new members and should establish a policy to give direction to the receiving and approval of new members. I have found a membership application form is a valuable tool to first set forth the requirements for membership in the cooperative and the member's responsibilities to the cooperative.

The stock redemption plan, interest on percentage dividends source of debt capital are all responsibilities of the board.

It is the board's responsibility to secure an audit and receive the audit report from the auditor.

Boards have the responsibility to approve the annual budget for the cooperative and to follow the activities of the cooperative to insure the budget is followed.

DISCHARGING RESPONSIBILITIES AS A BOARD

When discharging their responsibilities directly as a board, directors deliberate, ask questions, make decisions, and give instructions as a unit, not as individual board members. The following are some of the responsibilities the cooperative directors ordinarily handle directly as a board:

1. Take his position as director seriously and prepare himself to discharge his responsibilities in a professional manner.
2. Establish the objectives, consider and act on the policies, programs, budgets, and other management controls needed to direct the administration of the cooperative's affairs, and assure desired results.
3. Control and preserve the rights and conserve the assets, and exercise all the corporate powers of the corporation.
4. Select, fix the compensation, designate the responsibilities, and delegate to the general manager and regional boards, authority commensurate with the results for which they are held responsible with responsibilities set forth in a job description for boards and management.

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5. Review periodic analysis of members' needs and direct whatever long-range forecasting and planning activities are necessary to assure that all phases of the organizations' operations are adequately equipped to meet members' needs most effectively.
6. Maintain continuous control over the association's activities through the consideration and review of periodic reports, analysis, and statistics submitted by the general manager and the treasurer; compare the current position with the requirements of approved goals, programs and budgets; effect remedial action through the general manager whenever the need is indicated.
7. Consider the act on the membership applications recommended by the management and enforce existing membership contracts.
8. Assure that members' complaints and suggestions are sympathetically considered, that members are kept adequately informed of the affairs of the association, and that sound relationships, understanding, and communication are maintained between the management and members.
9. Have made annually an audit of the fiscal affairs of the association by an outside independent auditor, employed and reporting directly to the board.
10. Distribute cooperative's earnings.
11. Make long-range plans.
12. Devote the necessary time preparation for participation in board meetings.
13. Attend board meetings regularly.
14. Act in good faith and with reasonable care and prudence in handling the business and affairs of the cooperative.
15. Discharge their fiduciary responsibilities to their cooperative and the cooperative member.
16. Regularly hold an executive session of the board and entire board report immediately its concerns and actions to management.
17. Prepare and maintain manual of board policies.

Among the new rules emerging, it appears that attention should be given to bribes or sales incentives, conflict of interest, and misallocation of cooperative earnings to charity or other social causes.